IN THE

Supreme Court of the United States

October Term, 1964.

No. 644.

THE UNITED GAS IMPROVEMENT COMPANY,
Petitioner,

v.

CONTINENTAL OIL COMPANY, et al.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit.

BRIEF FOR PETITIONER, THE UNITED GAS IMPROVEMENT COMPANY.

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OPINIONS BELOW.

The Opinion of the Court of Appeals for the Fifth Circuit (R. 1277) is reported at 336 F. 2d 320 (5th Cir. 1964). The Opinions and Orders of the Federal Power Commission, reviewed by the Court of Appeals (R. 962-84, 1136-39 and 1223-33), are reported at 29 FPC 249 (1963), 29 FPC 692 (1963), and 30 FPC 153 (1963).

JURISDICTION.

The judgment of the Court of Appeals for the Fifth Circuit was entered on August 3, 1964 (R. 1289). The Petition for a Writ of Certiorari was filed on October 31, 1964 and granted on January 18, 1965 (R. 1292), — U. S. —. At the same time a Petition for Certiorari filed by the Federal Power Commission, attacking the same judgment on similar grounds, was granted and the cases consolidated for argument (R. 1292), — U. S. —. The jurisdiction of this Court rests on 28 U. S. C. § 1254(1) and § 19(b) of the Natural Gas Act. 15 U. S. C. § 717r(b).

STATUTE INVOLVED

The statutory provisions involved are contained in Sections 1(b), 7 and 19(b) of the Natural Gas Act, 52 Stat. 822 (1938), as amended, 15 U. S. C. §§ 717(b), 717f, 717r(b). The statutory language in these sections relied on herein is as follows:

"NECESSITY FOR REGULATION OF NATURAL-GAS COMPANIES

Section 1. . . . (b) The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

* * *

SEC. 7. (a) Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it may by order direct a natural gas company to extend or improve its transportation facilities, to establish physical connection of its transportation facilities with the facilities of, and sell natural gas to, any person or municipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden

will be placed upon such natural-gas company thereby: *Provided,* That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physical connection or sell natural gas when to do so would impair its ability to render adequate service to its customers.

(b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

(c) No natural-gas company or person which will be a natural gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however,* That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on the effective date of this amendatory Act, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate with-

but requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after the effective date of this amendatory Act. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however,* That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(d) Application for certificates shall be made in writing to the Commission, be verified under oath, and shall be in such form, contain such information, and notice thereof shall be served upon such interested parties and in such manner as the Commission shall, by regulation, require.

(e) Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition cov-

ered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

* * *

REHEARING; COURT REVIEW OF ORDERS.

Section 19 . . . (b) . . . The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. . . ."

QUESTIONS PRESENTED.

Producer-respondents in 1957 entered into sales contracts, conceded by all to be subject to Commission jurisdiction, with interstate pipeline-respondent at "out-of-line" initial price levels which, under then-existing Federal Power Commission precedent, were not subject to Commission regulatory scrutiny under § 7 of the Act with respect to the initial price. When the courts overturned this Commission precedent and held that under § 7 of the Act the Commission was required to scrutinize initial prices prior to certification, producer-respondents recast their sales transaction with interstate pipeline-respondent into a new form: bulk sale of the gas reserves in place for a lump sum adjusted to actual volumes of gas. The Commission found this sale to have the same effect as the originally planned sales, to be actually a sale of gas for resale in interstate commerce, and to be subject to effective price regulation. This Commission determination was reversed by the Court of Appeals. The questions presented therefore are:

(1) Was the Commission correct in finding that the subject transaction constituted a "sale in interstate commerce of natural gas for resale" which was therefore subject to its jurisdiction under § 1(b) of the Natural Gas Act?

(2) Did the Court of Appeals err in expanding the exemption for "production and gathering" contained in § 1(b) of the Natural Gas Act so as to nullify Commission jurisdiction over what the court below itself recognized to be a sale of natural gas in interstate commerce for resale?

(3) Did the Court of Appeals err by upsetting the Commission's finding that the subject natural gas sale transaction in its present form should not be certificated on the basis of the existing record?

STATEMENT OF THE CASE.

A. First Phase: The Original Sale Proposal.

On February 1, 1957, the four producer-respondents here, Continental Oil Company, General Crude Oil Company, M. H. Marr and Sun Oil Company, executed sales contracts, admitted by all parties to be subject to Commission jurisdiction, with pipeline-respondent, Texas Eastern Transmission Corporation (Texas Eastern), an interstate natural gas transmission pipeline, covering sales of gas from wells in the Rayne Field in South Louisiana. Texas Eastern carries gas from the Gulf area, including South Louisiana, to the Eastern Seaboard. The Rayne Field had been explored, drilled and developed as a unit by these producer-respondents under various leases from the landowners in the area (R. 208 *et seq.;* 386-88). Under these wholesale contracts Texas Eastern agreed to purchase the estimated 750 million Mcf of then-proven gas reserves in the Rayne Field (R. 5), and producer-respondents dedicated exclusively to Texas Eastern under these contracts a guaranteed minimum of 730 million Mcf of the Rayne Field reserves (R. 6). The contracts were for 20 years and the initial price fixed was 23.9¢ per Mcf, including tax reimbursement (R. 4-5, 130). The gas was to be paid for on the basis of the amount delivered to the pipeline during the billing period with provisions for minimum daily take requirements (R. 4).

In April, 1957, Texas Eastern applied for a certificate authorizing it to construct and operate a compressor station and connecting pipeline to transport the gas thus purchased from the Rayne Field to Opelousas, Louisiana, where the gas was to be delivered into its existing transmission lines. Concurrently, Continental and the other producers filed applications as required by § 7 of the Natural Gas Act for certificates to make these admittedly jurisdic-

tional sales of gas. At the time of the filings, of course, the developed field was not attached to Texas Eastern's or to any other interstate pipeline's system (Compare R. 395-98).

These related applications were noticed for hearing. The United Gas Improvement Company (Petitioner) [1] and other substantial Eastern seaboard customers of Texas Eastern intervened, as did the Public Service Commission of the State of New York. Intervenors were concerned—as they continue to be—with initial prices negotiated in the highly important South Louisiana area upon which intervenors are dependent for a substantial part of their natural gas supply. The initial price of 23.9¢ per Mcf which Texas Eastern proposed to pay for the Rayne Field gas was the highest price sought up to that time in South Louisiana. After hearing, the Examiner, over the protest of intervenors and the Commission's Staff, issued a decision on April 15, 1958, recommending unconditioned certification of the applications of the four producers (R. 367-405, 21 FPC 869-886).

While the producers' § 7 applications were pending before the Commission on exceptions by Petitioner and others to the Examiner's decision, the Court of Appeals for the Third Circuit decided the *"CATCO"* case, which set aside an order of the Commission granting unconditioned certification of gas sales by the CATCO producers (which include Continental Oil Company) from certain offshore Louisiana fields at an initial price of 22.4¢ per Mcf, including tax. *Public Service Comm'n v. FPC*, 257 F. 2d 717 (3rd Cir. 1958), *aff'd sub nom. Atlantic Ref. Co. v. Public Service Comm'n,* 360 U. S. 378.

The effect of the *CATCO* decision upon the present transaction is frankly described in a pleading filed by Continental Oil Company in a later phase of this case (R. 1014-

1. Under an agreement with the City of Philadelphia, The United Gas Improvement Company operates the municipally-owned Philadelphia Gas Works and related facilities. The gas works distributes 1035 Btu natural gas to some 600,000 customers in the City of Philadelphia. It also distributes gas to some 205,000 customers in other parts of Pennsylvania.

18). Therein Continental argues that just as this Court had permitted "confiscation" of producing properties in the *Interstate*[2] and *Colorado Interstate*[3] cases, so the Third Circuit and this Court in *CATCO* upset efforts of the Commission "striving to be fair in certifying new contracts for sales of new gas" (R. 1017) and presumably would have required "confiscation" of Continental's property herein. Thus seeing "the handwriting on the wall" (R. 1017), the producer-respondents rescinded their contracts with Texas Eastern and in July and August of 1958 and January, 1959, filed notices of withdrawal of their pending certificate applications (R. 406-10, 425).

B. Second Phase: The Revised Sale Proposal.

In September, 1958, Texas Eastern filed a petition to reopen the hearing and to amend its application (R. 411-22). Texas Eastern was now the only applicant, since the Commission had granted withdrawal of three producer certificate applications and had the fourth request for withdrawal under consideration (R. 406-10, 464). Texas Eastern's modified application called for certain minor changes in the design of its proposed pipeline facilities; it also reflected a change in the method of divesting Continental and the other producers of their interest in the Rayne Field gas and investing Texas Eastern with it. Instead of the earlier dedication for 20 years of some 750 million Mcf of gas to be sold at a price of so-much-per-Mcf, Texas Eastern stated that it had negotiated to purchase from the same four producers the same proved and developed gas reserves formerly committed to the rescinded contracts for a down payment and 16 periodic payments.

To effectuate the transfer Continental and the other producers on December 4, 1958, executed contracts with Louisiana Gas Corporation, an affiliate created by Texas

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2. *Interstate Gas Co. v. FPC*, 331 U. S. 682.
3. *Colorado Interstate Gas Co. v. FPC*, 324 U. S. 581.

Eastern for the purpose. Texas Eastern, by contract concurrently executed, obtained the right to acquire title to the leases from Louisiana Gas. Throughout the litigation, therefore, Texas Eastern has been treated as the real purchaser (R. 965).

This new agreement spelled out in somewhat more detail than the earlier contracts the geological features of the field. Five (later seven) separate reservoirs, or "sands," had been discovered and tested in the Rayne Field (R. 747-48). The lowest of these is called the Nodosaria "A" Sand, at a depth of 13,650 to 13,890 feet (R. 187). Sufficient wells had been drilled into all reservoirs to enable a geological consulting firm to map the reservoirs and attempt an estimate of the various reserves (R. 745-48).

Under the new agreement the producers transferred the aggregate of their leasehold rights received from the landowners covering all gas extracted from the seven reservoirs down to the base of the Nodosaria "A" Sand, together with wells and related equipment and rights of ingress and egress. At the same time, they reserved their "leasehold rights to the oil and other minerals, except gas and condensate" (R. 186-88). While the agreement thus appeared to pass to the pipeline the liquids, or "condensate," to be extracted from the gas, the conveyance was essentially one of form only, since it also provided that the producers would receive as "production payments" all proceeds from the sale of condensate in excess of the costs of operating the field and of processing expenses (R. 188-191). Thus the liquids which, on paper, Texas Eastern appears to have acquired under the lease agreement are actually resold to the producers under long term contracts and one part of the cash received by Texas Eastern therefrom is used to reimburse Continental for its costs in operating the field, while the remainder is rebated and distributed among all four producer-respondents.

The lease-sale agreement was executed with the understanding that Continental, which had previously operated

the field as agent for itself and the other producers, would continue to conduct all operations, including drilling, developing and managing the wells and well equipment. A "management agreement" to this effect was executed on July 27, 1959 (R. 827-858).

The consideration for the transfer from producer-respondents to the interstate pipeline of the proven gas reserves of the Rayne Field was $134,295,700 of which $12,420,500 was paid in cash and the balance in promissory notes payable in 16 annual installments (ending in 1975). These notes provided that should Texas Eastern determine that gas production should exceed a specified amount, similar in magnitude to the contemplated yearly take in the rescinded original sales contracts (compare R. 574 with R. 4), payment of the notes would be accelerated (in inverse order of maturity), under a formula geared to a stipulated quantity of gas production (R. 350-351). At the same time, no provision for deceleration was included and the burden of prepayment was thus shifted to Texas Eastern and its customers.

At the reopened proceeding dealing with Texas Eastern's revised application the Commission omitted the intermediate decision procedure and on June 23, 1959, issued its Opinion No. 322 (R. 449-67, 21 FPC 860), which unconditionally certificated Texas Eastern's proposal and in language and tenor appeared to confer general approval of the acquisition arrangement, including price.

C. First Court Appeal.

On July 23, 1959, the New York Commission applied for rehearing of Opinion 322 (R. 467). Four days thereafter the producer-respondents and Texas Eastern completed the transaction and Texas Eastern (which had constructed its short connecting line under temporary authority) began to receive Rayne Field gas into its interstate system. Subsequently, the Commission denied rehearing (R. 476) and the

New York Commission applied to the Court of Appeals for the District of Columbia, which set aside the certificate order and remanded for further proceedings. *Public Service Comm'n. v. FPC,* 287 F. 2d 143 (D. C. Cir. 1960) (R. 862). The court held that "the language and tenor of the Commission's Opinion and Order appear to confer general approval upon the terms of the acquisition agreement" without any basis in the evidence. Without considering the assumption, acquiesced in by all parties to the appeal, that the Commission had no jurisdiction over the agreement by which the gas was transferred, the court stated that, regardless of the transaction's form, the Commission had the power to inquire into the cost to Texas Eastern of acquiring the gas and to ascertain whether such costs would be consistent with the public convenience and necessity as required by § 7 of the Act.

D. Remanded Proceedings.

On remand the Commission reopened the proceeding, and Texas Eastern then undertook to present further evidence relative to its cost of acquiring the gas in the Rayne Field. Despite the passage of time and the experience gained in actual operation after July, 1959, Texas Eastern's evidence in the reopened proceeding, and its legal arguments as well, were substantially similar to those contained in the record found wholly inadequate by the Court of Appeals for the District of Columbia. This stage of the record was summed up by the Examiner in his opinion when he stated that it was "virtually impossible from the record, to determine the future costs to Texas Eastern for the Rayne Field since they are predicated upon assumptions and estimates" (R. 891-92). Looking at Texas Eastern's own estimates on their face the Examiner noted that "when all [Texas Eastern's] costs, and estimated costs are computed, the average cost becomes 24.34¢ per Mcf at 15.025 psia" (R. 896). The Examiner did not make a

cost finding on the basis of such a record, but instead on the basis of precedent and the record concluded that the price for the Rayne Field gas that would not be "out of line" at the time Continental and the other producers first negotiated with Texas Eastern was 18.5¢ per Mcf (R. 897). Therefore, he held that Texas Eastern should be granted a certificate under § 7 of the Act conditioned upon the inclusion of the Rayne Field gas in the pipeline's cost of service at an initial price of 18.5¢ per Mcf (exclusive of tax) and on its maintenance of special accounts providing "summary and detailed data respecting the cost of the Rayne Field gas to Texas Eastern" (R. 897-98).

The Examiner noted that Petitioner herein and the Commission Staff "vigorously contend in their briefs the Commission does have jurisdiction over such [Rayne Field gas] acquisitions" (R. 885) as it had over their predecessor sales. He concluded, however, that the Commission was without jurisdiction "until (1) the gas was connected to an interstate system of pipelines or (2) the gas was dedicated to a sale in interstate commerce" (R. 887).

On exceptions the Commission noted the history of the Rayne Field transaction and found the following facts with respect to it:

> "(1) Only gas in particular strata is conveyed; and the producers retain their interest in oil and other minerals;
>
> (2) In effect the transaction is for the sale of stripped gas inasmuch as the producers are to receive a production payment from Texas Eastern from the sale of natural gas liquids;
>
> (3) While the payment for the leases is represented by notes and spread over a 16-year period, the notes have an acceleration clause by which payment is accelerated if production is increased, so that Texas Eastern's payments would be geared to production;

(4) By a management agreement dated July 27, 1959, Continental agrees to operate the field, including drilling wells and managing all wells and equipment, and to deliver to Texas Eastern specified minimum daily quantities of gas; Texas Eastern will reimburse Continental for its expenses in operating the field but the assignment of the leases shows that the costs of operating the leases will be defrayed out of the production payments to which Continental is entitled;

(5) It is Louisiana Gas, not Texas Eastern which is liable on the notes to the producers, so that the true purchaser of the gas is not bound by the principal obligation of the lease sale transaction." (R. 973; 29 FPC at 254)

Based on these findings the Commission concluded that the principal effect of the transaction was to consummate transfer of gas between producer-respondents and Texas Eastern for consideration. The effect of the transfer was substantially identical with the potential effect of the earlier transaction between the same parties, which was concededly jurisdictional.

Since the gas acquired by Texas Eastern could only flow, and was in fact flowing, in interstate commerce and the price paid therefor had an impact only upon the price paid for gas by the interstate consumer, which Congress intended to be regulated nationally under the Natural Gas Act, the Commission held that the transaction was subject to its jurisdiction.

As the inevitable consequence of this holding, the Commission further held that certification of such a jurisdictional sale by producer-respondents was required by § 7 of the Act. And the record made by Texas Eastern was more than ample to demonstrate that the transaction before it was not susceptible of effective regulation. By its form it compelled a "one shot" exercise of regulatory scrutiny on the basis of estimates and assumptions seriously called in

question by cross-examination. The Commission concluded that it would not be in the public interest to certificate the present sale in its bulk form on the basis of the existing record.

All the producer-respondents and the pipeline-respondent, Texas Eastern, filed petitions for rehearing which were denied, upon which they petitioned the Court of Appeals for the Fifth Circuit for review.

On August 3, 1964, that court reversed the Commission's jurisdictional finding and remanded the case to the Commission for further hearing and consideration of Texas Eastern's application alone since it held that the Commission had no jurisdiction over producer-respondents. The Fifth Circuit made no analysis of the transaction or of the statutory basis for jurisdiction. Instead the court's decision is predicated wholly on what it took to be the binding effect of an earlier decision of this Court, *FPC v. Panhandle Eastern Pipeline Co.*, 337 U. S. 498. The court below noted that in *Panhandle* this Court had classified the leaseholds there involved as being part of the "physical activities, facilities and properties" used in production and gathering. Thus, reasoned the court below, they fall within that part of § 1(b) of the Natural Gas Act which exempts "the production or gathering of natural gas" from Commission's jurisdiction. The court below then examined the "Assignment and Conveyance" between the producer-respondents and Texas Eastern and disagreed with what it erroneously took to be the Commission's conclusion—that the document embodied exclusively a sale and was not "really" a lease as the term was used in *Panhandle*. Therefore, the court below found no occasion to consider the legal principles which had actually correctly governed the Commission's decision, those applicable in the common situation in which the "physical activities, facilities and properties" used in production and gathering are the instrumentalities of a sale of gas in interstate commerce—which is subject to the Commission's jurisdiction.

SUMMARY OF ARGUMENT.

The basic issue posed herein is whether the present lease sale transaction by which the rights to the developed gas reserves were transferred from the producers to the interstate pipeline in fact embodies a sale of natural gas for resale in interstate commerce, and thus falls within the broad jurisdictional grant in § 1(b) of the Act, over all sales of natural gas for resale in interstate commerce, *Phillips Petroleum Co. v. Wisconsin*, 347 U. S. 674, or whether the transaction is, solely by virtue of the lease form chosen by the parties, so materially transformed into a local activity, facility or property of production as to remove it from the ambit of the basic broad grant and draw it within the narrow exemption. This is a question which cannot be resolved by any examination of local law of sales or real property, which varies from state to state, but must be derived from a thorough analysis—such as that made by the Commission—of the facts and effect of the transaction in the light of the broadly remedial Congressional intent as interpreted by this Court. The present transaction involves the very type of transfer of interest in gas from producer to interstate pipeline which Congress intended, by its grant of jurisdiction in § 1(b) over "sales in interstate commerce of natural gas for resale," to subject to uniform federal regulation. The practical effect of the present bulk sale and its impact upon the consumer is identical with other admittedly jurisdictional sales. Whether gas is transferred from the producer to the interstate pipeline by the producer's agreeing to dedicate the reserves for twenty years and the pipeline's agreeing to pay for the gas as delivered or instead by the producer's immediately transferring its rights to all of the gas in place to the interstate pipeline and the pipeline's committing itself to pay a sum commensurate with the estimated reserves, there is a sale for resale in interstate commerce. There

is no rational policy reason why Congress should have intended to exempt one and subject the other to regulation. All such sales by reason of their effect in transferring gas into interstate commerce, are wholly interstate in economic impact, not arguably local in impact like the transfer of undeveloped leases to a producer for intrastate sale which was the subject of this Court's pre-*Phillips* decision in *FPC v. Panhandle Eastern Pipe Line Co.,* 337 U. S. 498.

The opinion of the court below erroneously applied this Court's *Panhandle* decision. The *Panhandle* case dealt with a transfer of undeveloped leases from a certificated jurisdictional interstate pipeline company to a producing company bound by contract to sell *intrastate* only. The jurisdictional issue raised and decided there involved the Commission's control over a non-jurisdictional activity in order to effectuate §§ 4, 5, 7 and 16 of the Act in the light of the "production and gathering" exemption of § 1(b). In other words, the Commission claimed "protective jurisdiction." The court below erroneously read *Panhandle* as conclusively classifying all lease transfers (whether of developed or undeveloped gas reserves) as "facilities of production" regardless of their potential status under other sections of the Act which were not considered in that case. Thus the court below never reached or decided the central question herein of whether the subject transaction embodied a sale within the meaning of the affirmative jurisdictional grant contained in § 1(b) of the Act, regardless of whether or not it also embodied certain *bona fide* indicia of a sale of leases. Instead of resolving this crucial issue, the opinion below dealt exclusively with a spurious question, which it misconstrued the Commission's opinion and brief as raising, of whether the lease terms herein were sham under prevailing concepts of local sales and conveyancing laws. Citing various treatises on these subjects the court below said that while gas was sold, there were also certain *bona fide* indicia of a lease sale present (passing of rights to wells and equipment, of ingress and egress and manage-

ment) and it therefore mechanically applied its erroneously broad construction of the *Panhandle* classification. The result thus reached is beside the point of the case and erroneous in its effect.

The effect of the expansion of *Panhandle* effected by the court below is to roll back the traditional effective scope of Commission regulation of interstate gas rates and to give to private parties the discretionary means to avoid such regulation. The rationale of the court below, which equates *all* leases and transactions involving them with facilities exclusively of production within § 1(b)'s narrow exemption, led to this unforeseen and unfortunate result. It is based on a serious misreading of the *Panhandle* case, which should be reversed and the decision of the Commission should then be affirmed.

Finally, the Commission's conclusion as a matter of discretion not to grant Texas Eastern's application under § 7 of the Act for certification of the subject transaction in its existing bulk form was supported by the record and should be affirmed.

ARGUMENT.

A.

The Subject Transaction Was a Sale in Interstate Commerce of Natural Gas for Resale Subject to Commission Regulation Under the Natural Gas Act.

Section 1(b) of the Natural Gas Act provides:

> "*The provisions of this act shall apply* to the transportation of natural gas in interstate commerce, *to the sale in interstate commerce of natural gas for resale* for ultimate public consumption for domestic, commercial, industrial or any other use, *and to natural-gas companies engaged in such* transportation or *sale, but shall not apply* to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or *to the production or gathering of natural gas.*" (Italics added.)

This Section confers on the Federal Power Commission a broad grant of authority over all sales of natural gas from producers to pipelines in interstate commerce for resale. Though it was not strictly needed, Congress inserted in § 1(b) a proviso that the Commission's jurisdiction did not cover activities solely relating to production or gathering of natural gas. This proviso, however, does not limit the affirmative grant of Commission jurisdiction over sales in interstate commerce. As pointed out in the House Report on the ~~Bill which~~ became the Natural Gas Act, the exemptive clause in § 1(b) was clarifying in nature only: any activity which would be solely a part of production or gathering of natural gas—such as proration of gas, unitization of fields, well spacing, secondary recovery and so forth—would necessarily not involve sales in interstate commerce. The House Report states:

"The quoted words [of the exemption] are not actually necessary, as the matters specified therein could not be said fairly to be covered by the language affirmatively stating the jurisdiction of the Commission, but similar language was in previous bills, and, rather than invite the contention, however unfounded, that the elimination of the negative language would broaden the scope of the act, the committee has included it in this bill." H. R. Rep. No. 709, 75th Cong., 1st Sess.[4]

In the leading case construing the scope of the affirmative grant of jurisdiction, *Phillips Petroleum Co. v. Wisconsin*, 347 U. S. 672, this Court indicated that the grant intended by Congress was broad, stating:

"... [W]e believe that the legislative history indicates a congressional intent to give the Commission jurisdiction over the rates of *all* wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company." 347 U. S. at 682. (Italics added.)

See also *Colorado Interstate Gas Co. v. FPC*, 324 U. S. 581; *Interstate Gas Co. v. FPC*, 331 U. S. 682. Since *Phillips* the Commission has regulated all such sales and its action has been sustained by various Courts of Appeals. *J. M. Huber v. FPC*, 236 F. 2d 550 (3rd Cir. 1956), *cert. denied*, 352 U. S. 971; *Saturn Oil & Gas Co. v. FPC*, 250 F. 2d 61 (10th Cir. 1957), *cert. denied*, 355 U. S. 956; *Deep South Oil Co. v. FPC*, 247 F. 2d 882 (5th Cir. 1957), *cert. denied, sub nom. Humble Oil & Ref. Co. v. FPC*, 355 U. S. 930; *Continental Oil Co. v. FPC*, 266 F. 2d 208 (5th Cir. 1959), *cert. denied*, 361 U. S. 827. The present case is therefore controlled by the statutory language granting jurisdiction over

4. The Senate Report adopted and reprinted the House Report on the Bill, S. Rep. No. 1162, 75th Cong., 1st Sess.

sales in interstate commerce for resale, and the bulk form of the sale has no statutory significance on the issue of jurisdiction.

Prior to the present case the Commission had never been faced with the precise factual situation presented herein by the revised proposal: the Rayne Field, at the time of the lease transfer between the producers and the pipeline, was a developed, large-scale gas-condensate field. It had been explored and tested to the point where the producer-respondents could negotiate to make contracts for immediate wholesale sales of gas, commit them for 20 years and support them by dedication of specified reserves. At that point, as to the gas underlying the field, the producer-respondents had the exclusive right to shut it in, or to produce and sell it in intrastate commerce or in interstate commerce as they saw fit. Then, for a given amount of money, they conveyed all their rights pertaining to the gas to Texas Eastern, an interstate pipeline, and Texas Eastern has exercised its newly acquired rights to take the gas and to transport it in interstate commerce for resale for ultimate public consumption.

The court below, because of its erroneously broad reading of the *Panhandle* case, was misled by lease elements in the transaction and treated it in terms of conventional property law. It construed the arguments of the Commission below as being predicated upon an attempt to show that the present transaction was a sham, that it was not "really" a lease. 336 F. 2d at 324.

The court found this spurious issue easy to resolve. It stated that the " 'Assignment and Conveyance' not only passed rights to the gas, but also passed rights to wells and related production equipment and rights of ingress and egress." *Ibid.* It further noted that the various other limitations on the transfer were not unusual to lease transfers.[5] It is not Petitioner's purpose to dispute these points,

5. In so deciding it relied upon various treatises and articles dealing with local conveyancing law. 336 F. 2d at 325.

for it is clear that they are not conclusive of, or even relevant to, the issue presented to this Court. If they were, federal jurisdiction would have passed from the hands of Congress to those of the parties and the affirmative grant of jurisdiction over sales of natural gas in interstate commerce for resale contained in § 1(b) would yield to an expansion of the exemptive language contrary to the intent of Congress and this Court's decision in *Phillips*.

When the court below recognized that the transaction passed "rights to the gas," 336 F. 2d at 324, it touched the crux of the case, although the court failed to give it appropriate legal significance. The party controlling rights to gas which is developed and ready for production controls the gas and is the beneficiary of any value it may have. Whether the sale is viewed, by convention, as being consummated below the well-head, with title, or whatever interests the parties have, passing "in the ground," or at the well-head, it is a sale of gas and the type of transaction contemplated by the phrase "sale of natural gas" in § 1(b) of the Act.

Because of its volatile physical nature, gas can never be made available above the ground in more than small quantities in an enclosed stream at a given time. This physical limitation does not prevent the contracting for wholesale sales of the commodity, between producer and pipeline and between pipeline and distributor, and the point on the continuous volatile stream at which title, or whatever right parties have in the molecules, is treated as passing, is a convention for purposes of the various legal consequences which turn on title. In many states, including Texas, title is treated as attaching to minerals in the ground (*Cf.* R. 723). It was precisely such wholesale sales of gas that the Natural Gas Act was enacted to regulate. Congress clearly did not intend federal jurisdiction and regulation to depend on the particular state in which the gas might be located or the legal skill of private parties in manipulating the convention of title.

The fact that in addition to selling gas the producers here have relinquished other rights (to wells, equipment, ingress and egress) for additional consideration, does not alter the practical effect of the transaction relating to the gas molecules. It means only that the producers sold gas *plus* other personal property. The adding of the plus can in no way change the jurisdictional status of the sale of the gas. The Commission has no jurisdiction over the sale of well equipment or over operating decisions whether and where to drill or deepen wells, to use secondary recovery or recycling, or to regulate volume of production. Therefore it is irrelevant to federal jurisdiction how the production activities are handled. They are the subject of the exemption in § 1(b) and are under state regulation. The price charged by the producer and paid by the interstate pipeline for molecules of gas acquired, however, is subject to federal regulation. *Phillips Petroleum Co. v. Wisconsin, supra.* That is the decisive factor in the present case.

The reasons for this jurisdiction have long been clear from the legislative history of the Act and the decisions of this Court. As early as 1947 in *Interstate Natural Gas Co. v. FPC*, 331 U. S. 682, this Court pointed out:

> "All the gas sold in these transactions is destined for consumption in States other than Louisiana. Unreasonable charges exacted at this stage of the interstate movement become perpetuated in large part in fixed items of cost charged subsequent purchasers of the gas, including the ultimate consumer. It was to avoid such situations that the Natural Gas Act was passed." 331 U. S. at 692-93.

See also *Phillips Petroleum Co. v. Wisconsin, supra* ("Protection of consumers against exploitation at the hands of natural gas companies was the primary aim of the Natural Gas Act"); *cf. Atlantic Ref. Co. v. Public Service Comm'n*, 360 U. S. 378, 388 ("The Act was so framed as to afford

consumers a complete, permanent and effective bond of protection from excessive rates and charges."); *FPC v. Transcontinental Gas Pipe Line Co.*, 365 U. S. 1, 19 ("[I]t is . . . clear that Congress did not desire that an important aspect of this [natural gas] field be left unregulated.").

Any argument that the exercise of such jurisdiction will constitute an expansion of federal authority into new areas and areas of local interest places unjustified stress on labels such as "lease" and ignores the precise facts of the present case. The present exercise of Commission jurisdiction is over a transaction which is clearly jurisdictional—the commitment and transfer of gas wholesale, but by physically limited delivery, from the developer of a gas field to an interstate pipeline for delivery interstate. Any "gap" forbidding Commission regulation of such a transaction would not be one created or intended by Congress or by this Court in *Panhandle.*[6] It would be one of the parties' own making. The decision of the Commission intended to eliminate this influence of private parties and viewed jurisdiction in terms of the physical facts of the transaction and the intention of Congress expressed in clear language. *Cf., California v. Lo-Vaca Gathering Co.*, — U. S. —, 85 Sup. Ct. 486. That the State of Louisiana exercises no regulatory authority over the price aspects of the subject sale transaction is another indication of the correctness of this Commission decision, *FPC v. Transcontinental Gas Pipe Line Co., supra* at pp. 19-20. The Commission's decision should be affirmed.

B.

The Panhandle Case.

The above analysis makes it clear that this Court's *Panhandle*[7] opinion, which predates *Phillips*, has no bearing on the jurisdictional status of the producer-interstate pipe-

6. *FPC v. Panhandle Eastern Pipe Line Co.*, 337 U. S. 498.
7. *Ibid.*

line transaction here under scrutiny. For there is nothing in *Panhandle* which changes the fact in the case at bar: that since gas was transferred from the producers to the interstate pipeline for resale it is subject to Commission jurisdiction pursuant to § 1(b). In the *Panhandle* case, Panhandle Eastern Pipe Line Company, an interstate pipeline, was a "natural gas company" within the meaning of § 1(b) of the Act, as a company which transported natural gas in interstate commerce. This determination was made long prior to the litigation in that case. As such, Panhandle had sought and received certificates of public convenience and necessity from the Commission to build certain facilities, to operate other facilities and to make sales. To obtain such certificates it relied in part upon potential reserves from certain undeveloped leases. As a natural gas company, Panhandle was subject under §§ 4 and 5 of the Act to regulation of its rates on the basis of a rate base comprehending all its property used and useful in its natural gas business.

The controversy in the *Panhandle* case, in contrast to that in the present one, turned upon the extent of the Commission's authority to go beyond its certificating and rate-making function and to interfere with the management decisions of Panhandle dealing with its property, where such dealing might have a significant indirect effect upon those Commission functions, even though the transaction complained of was not a sale of gas in interstate commerce for resale.

Panhandle proposed to alienate certain of its leased properties. The transfer was to a producing affiliate of the pipeline, which was bound by contract to develop the leases and sell the gas therefrom entirely in the intrastate market in Kansas. The Commission believed that the alienation of the potential reserves represented by those leases would seriously impair the ability of the interstate pipeline to perform in accordance with its certificate of public convenience and necessity, which had been based in part upon those

very reserves. Therefore the Commission ordered a hearing into the effect of the lease transfer. However, the date for transfer of the leases was approaching and, to preserve the status quo, the Commission asked a United States District Court to restrain the pipeline company temporarily from completing the transaction until after the Commission had carried out its legitimate investigation.

The District Court refused the restraining order and was affirmed by the Court of Appeals for the Third Circuit, which held the leases on undeveloped gas property to be a "facility" of production and therefore exempt from Commission jurisdiction under § 1(b). *FPC v. Panhandle Eastern Pipe Line Co.*, 172 F. 2d 57 (3d Cir. 1949).

The Commission appealed to this Court. It relied on §§ 4, 5, 7 and 16 of the Act. The thrust of its argument was that effective exercise of its regulatory powers under those Sections could only be carried out if it had control over Panhandle's disposition of the subject matter of the regulation—which included leases on undeveloped gas properties, as well as pipe, facilities and other tangible assets. This highly controversial question of "protective" jurisdiction was resolved against the Commision by a narrow majority of this Court.

The present case, in contrast to *Panhandle*, involves a transfer of fully developed leases from producers to an interstate pipeline and the gas to be extracted from the properties is to flow entirely in interstate commerce. In the present case the Commission found a sale of gas in interstate commerce and is defending that finding in this Court, whereas, in *Panhandle* no such finding was made. In fact, no such issue was even raised, nor could it have been, since the gas involved there was destined for intrastate commerce. The decision by this Court in *Panhandle* as to the extent of the Commission's power to protect its authority under §§ 4, 5, and 7 to regulate a natural gas company can throw no light whatsoever on the entirely

different question raised herein of the existence of a jurisdictional sale in interstate commerce under § 1(b) of the Act.

On this question of statutory construction the closest precedent is not *Panhandle,* but those cases in which this Court and others construed an alleged conflict between the broad basic jurisdictional grant in § 1(b) and the limited exemption therein. *E.g., Phillips Petroleum Co. v. Wisconsin,* 347 U. S. 672; *Interstate Gas Co. v. FPC,* 331 U. S. 682; *Colorado Interstate Gas Co. v. FPC,* 324 U. S. 581; *Saturn Oil & Gas Co. v. FPC,* 250 F. 2d 61 (10th Cir. 1957), *cert. denied,* 355 U. S. 956; *Continental Oil Co. v. FPC,* 266 F. 2d 208 (5th Cir. 1959), *cert. denied,* 361 U. S. 827. Also relevant to the present controversy is this Court's recent decision in *California v. Lo-Vaca Gas Co.,* — U. S. —, 85 Sup. Ct. 486, in which the opinion states:

> "Attempts have been made by one convention or another to convert a local transaction into one of interstate commerce [cite] or to make a segment of interstate commerce appear to be only intrastate. [cite] But those attempts have failed."

This Court has not permitted private parties by contract to usurp the power of Congress to fix jurisdictional limits.

An analysis of *Panhandle* shows that the important issues raised in the present case were necessarily not raised or decided therein. At the same time the very different issues decided in Panhandle do not control the present case.[8] Thus the present case is one of first impression in

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8. Some of the language of the *Panhandle* opinion, which discusses in broadly couched terms the intent of Congress and the scope of the exemption contained in Section 1(b), was not necessary to a decision of the precise issues before this Court in that case. This language amounted to dictum and is directly counter to the construction of Congressional intent given the Natural Gas Act by this Court in such subsequent leading cases as *Phillips Petroleum Co. v. Wisconsin,* 347 U. S. 672, *Atlantic Ref. Co. v. Public Service Comm'n.,* 360 U. S. 378, and *Sunray Mid-Continent Oil Co. v. FPC,* 364 U. S.

the sense that it represents the first call upon the Commission to regulate a bulk sale of natural gas. Under the clear language of the statute and the decisions of this Court such a sale is subject to the Commission's jurisdiction.

C.

The Treatment of the Existing Lease Sale Transaction Is Supported by the Record.

In addition to its finding of jurisdiction, the Commission made the following independent finding of fact in the exercise of its expertise under § 7(e) of the Act:

> "It is clear from the record of this case that it is not in the public interest for this Commission to certificate a transaction such as the one presented to us on this record." 29 FPC at 256 (R. 976).

This Court in *Atlantic Ref. Co. v. Public Service Comm'n.,* 360 U. S. 378, reversed the Commission for failure to give "careful scrutiny" to the initial price of a sale. The Commission found that the present sale in its bulk form defied such scrutiny on the basis of the record made by Texas Eastern. In the earlier phase of this case the Court of Appeals for the District of Columbia Circuit reversed the Commission for approving the present transaction on the basis of the following criteria:

> ". . . [W]e have considered all the circumstances pertaining to the company's acquisition of the Rayne Field leases and the effects of this transaction on the need and convenience of the public proposed to be served, including the extent and accessibility of

137. One suspects that it is this broad language upon which respondents rely when urging the authority of *Panhandle* herein, rather than the precise holding of the case, which did not in any way involve the affirmative grant in § 1(b). If so, it is an unfounded reliance. This Court is not bound by the since-discredited dictum of a former bare majority, when the clear language and policy of the Act run contrary.

> this gas supply; the benefits thereof in enabling Texas Eastern to meet consumer demands; the terms and conditions of the lease sale and purchase agreements including the price to Texas Eastern of the gas thereunder; the claimed savings accruing to Texas Eastern from acquiring the leases rather than purchasing the gas under gas purchase contracts; and the other factors present here." (R. 456)

At the reopened proceeding the evidence offered by Texas Eastern was directed solely to the same criteria. The Examiner found that whatever approach was used to calculate a unit price per Mcf for the gas, such price was out of line with contemporaneously executed gas sales contracts (compare R. 895-96 with R. 897). On the basis of such a record the Commission was amply justified in concluding that Texas Eastern had failed to show that the existing means of acquiring the Rayne Field gas was one which comported with the present and future public convenience and necessity. The public convenience and necessity standard of § 7 is one that looks to the future. It was well within the Commission's discretion to conclude here that the public interest did not require a situation in which Texas Eastern's customers were committed irrevocably to a fixed price for a substantial portion of their gas supply just at the time when an area rate proceeding investigating the just and reasonable rates for gas in South Louisiana was in progress which would determine the rate level—certainly a considerably lower one—which should prevail for that gas. The fact that a number of reasonable alternatives to the existing arrangement are possible, in bulk or unit form, any one of which would permit the type of regulation which would protect all parties, is a further factor justifying the Commission's discretionary refusal to certificate Texas Eastern's application based on that arrangement, even if the Commission lacked power to

compel the use of any specific alternative. *City of Pittsburgh v. FPC*, 237 F. 2d 741, 751 n.28 (D. C. Cir. 1956). The Commission's finding was proper and should be affirmed.

CONCLUSION.

The present case is of great importance to Petitioner not just for the potential impact one way or the other on the cost of Rayne Field gas, which will be reflected in the cost of purchased gas to Petitioner, but because it is that type of case which has far-reaching potential as adverse precedent. When the parties to the present transaction found the means to alter the form of a jurisdictional sale in such a way as to retain its economic substance, but to have the Commission at first accept its form as nonjurisdictional, they effected a "roll back" in the area of federal regulation that was soon widened by others. Four other similar transactions were soon after initiated: *Tennessee Gas Transmission Co., et al.,* Docket G-14562, *et al.* (Blocks 46 and 64, So. La.); *Tennessee Gas Transmission Co., et al.,* Docket CP61-106, *et al.* (Bastian Bay, So. La.); *Monterey Gas Trans., et al.,* Docket CP62-88, *et al.* (King Ranch, Texas); *Continental Oil Co., et al.,* Docket RI64-129 (Ship Shoal, So. La.). The trend was unmistakeable. Only the alertness of a re-constituted Commission after 1961 stood in the way of this erosion of consumer protection, the primary object of the federal statute. The court below, while ostensibly only applying mechanically a precedent of this Court, in effect would inadvertently condone a privately devised "gap" in the regulation of interstate sales by producers to interstate pipelines which makes and would make the "gaps" prevented in *FPC v. Transcontinental Gas Pipe Line Co., supra,* and *California v. Lo-Vaca Gathering Co., supra,* insignificant by comparison. For the reasons discussed in this brief, the legal basis of the decision of the Court of Appeals was erroneous

and should be reversed. Such a reversal will at the same time go far to safeguard for the future the traditional bounds of federal regulation of the sale of natural gas in interstate commerce.

For the foregoing reasons this Court should reverse the decision of the Court of Appeals for the Fifth Circuit and remand to that court with the order that the decision and Orders of the Commission embodied in its Opinions 378 and 378-A be affirmed.

Respectfully submitted,

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